Panel 4: Effective Corporate Governance Structures to Improve Performance

Session Synopsis
Corporate governance is the backbone of the financial sector and touches all aspects of an organisation. Having appropriate and effective governance is a critical aspect for any organization as it determines how organizations are guided, controlled and managed and underpins the discipline on which a business is run. Further, good governance builds confidence and helps attract investment. While different organizations will require their own specific governance structure depending on their scope and size, the underlying principles for good governance remain the same.

In the case of MFIs and other financial institutions, good governance plays an important role in helping to improve their performance. Key elements of a practical governance framework include a functioning board (the board of directors is the heart of corporate governance); shareholder practices, rights and protections; control and assurance within the operation; transparency and disclosure of information; and succession planning.

The Importance of Corporate Governance

Corporate governance underpins effective organizations, be they state owned enterprises, small to medium enterprises, microfinance institutions or other financial services providers. Good corporate governance creates confidence within the organization, as well as the trust of shareholders, investors, and most importantly, customers. However, achieving good corporate governance and meeting everyone’s expectations can be challenging and often involves a wide range of stakeholders including clients, who have an interest in the organisation providing good products and services and value for money; investors, who look for security and return on investment; and governments, looking to ensure that organizations are adequately meeting regulations, contributing to financial system stability and ideally, making a positive impact on the economy.
Having effective corporate governance structures also plays an important role in the long-term success of an organization as it enables a company to plan ahead and understand the broader implications of their work. One area of particular importance is attracting the right people to direct the company and make board-level decisions. This is a significant challenge across the Pacific with relatively small populations and with corporate structures and cultures being relatively new to the region. Company directors need to be critical thinkers so that they can scrutinize board papers and query management performance and proposals, with board appointments based on merit rather than political, cultural or social ties.

The key responsibilities of a board should include:

1. Setting the company’s overall mission, and following through with appropriate strategies;
2. Attracting appropriate equity investment and/or securing debt finance;
3. Oversight of major capital expenditure;
4. Oversight of financial and operational controls (and compliance);
5. Management of high level human resource decisions and policies; and
6. Ensuring regulatory/statutory obligations are met.

While the board is at the heart of corporate governance, it is important for there to be a clear demarcation of board and management responsibilities.

The Structure and Key Functions of a Board

Board directors need to have a good understanding of most issues faced by the organisation. Boards should be diverse in composition, with a mix of skill sets in areas such as accounting and law, as well as external directors drawn from wider industry, having academic expertise in microfinance, or a microfinance leader from another market. Experience on other boards is valuable, but if a director becomes over committed to too many boards, some may suffer from a lack of attention. In terms of decisions and policies, the Shareholder agreement should provide a high level guide as to how the company should run, as well as the roles and responsibilities of investors, the board and other key stakeholders. Appointments should follow the guidelines set out in the shareholder agreement.
Many institutions in the Pacific have or are being devolved from government, with lingering expectations of politicians sometimes diverging with the charter of these new, independent organisations. Independence of the board (and board appointments) is of particular importance. Political interference can be minimized by specifying required qualifications in an organization’s legislation, articles of association, shareholder agreement, or other constitution; advertising the director’s position; and making the process of appointment as transparent as possible. Directors need to be aware that their fundamental duty of care is to the company, not shareholders/investors.

In the Pacific, individuals are subject to a multitude of complex influences – from family, the tribe, community, politics, etc., with the standard of governance reflected in how power is exercised in the management of the institution.

Assessing risk is an important task for board members. The types of risks a board needs to consider will cover geographic, environmental, financial, market, and operational risks, with each needing to be assessed in terms of likelihood and severity. Once risks are identified, responsibility for monitoring and management needs to be assigned. One strategy that the boards of larger organisations adopt is the use of independent audit committee which reports to the board rather than management. Risk profiles can be prepared and reported on at board meetings.

Conflict of interest and related party transactions can be addressed through disclosure at the outset of each board meeting, and promoting a culture of absolute transparency in board deliberations and decisions.

Proportionality should apply to governance, as the governance requirements for large commercial organisations would overwhelm smaller organisations and groups. Where possible legislation should be rationalised and keep governance regulations and expectations as simple as possible. What is important is the practical application of basic governance principles. Vanuatu has a graduation provision within financial institution legislation that add more stringent provisions as MFIs grow through various financial and operational thresholds.
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